UNITED STATES BANKRUPTCY COURT

DISTRICT OF MINNESOTA

In re:

Amare Gurmu Solomon,

Debtor.

BKY 12-33993

Chapter 7 Case

Amare Gurmu Solomon,

Plaintiff,

vs.

Student Loan Finance Corporation, Education Loans Incorporated, and GOAL Funding II, Inc.

Defendants.

ADV 12-03276

PLAINTIFF'S REPLY MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

The parties agree that the operative language in this case is this exception to discharge contained in 11 U.S.C. §523(a):

> "(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for--
>
> (A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or
>
> (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or
>
> (B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;"

However, the parties disagree about the meaning of this subdivision. Defendants say the language is clear and quote a Massachusetts Court which said the plain language of the section would apply to those other than the student obligor. (*Defendants' Memorandum in Oppositon to Plaintiff's Motion for Summary Judgment*, p. 5). Of course, other courts have looked at the same plain language and arrived the opposite conclusion. Defendants say the language draws no distinction between obligors on an educational loan. (*Defendants' Memorandum in Oppositon to Plaintiff's Motion for Summary Judgment*,p. 4). Defendants have repeatedly stated that Mr. Solomon guaranteed a loan and the terms of the loan required the proceeds to be used for educational purposes.

All of these arguments miss the point. The obligation was not for the education of the debtor. The debtor signed a guarantee to accommodate a friend, not to further his education. The obligation was a guarantee of a loan for someone else's education. As in *Kirkish*, and all the other cases cited in support of debtor's motion, the debtor received no educational benefit of any kind, except for the object lesson not to guarantee an obligation of someone he does not know really well.

The language of the note that the proceeds could be spent only for educational purposes restrained only Mr. Bankole. Mr. Solomon had no right to control the expenditure of the proceeds and received no benefit of any

kind other than the satisfaction derived from helping a supposed friend. Several cases cited by debtor, such an *Meier*, distinguish between the primary educational loan and the secondary guaranty.

In other words, debtor does not argue that he should not be liable for an educational loan of his. He argues that the debtor's obligation as a guarantor is not an educational loan of the debtor. Debtor's education was not furthered by the loan. The provisions of the note that proceeds can only be spent for educational purposes is one of the many parts of the note that only apply to the student and not to the guarantor. Debtor had no legal right to spend any of the loan proceeds for his education. As in the *Boylen* case,

> "This debtor has received no benefit from the student loan debt in question. It was not he but his former wife, Lucille Boylen, who received the education. Moreover, he does not even have the benefit of a higher family income due to Mrs. Boylen's education because of the fact that the parties are now divorced. The Court finds that Congress had no intention to except a co-maker's liability on a student loan debt from discharge. Such an exception would be utterly contrary to the fresh start pervasive throughout this Bankruptcy Code and the Bankruptcy Act of 1898 and the purposes for which this exception was enacted. *Boylen*, 29 B.R. 924, 926-927 (N.D. Ohio 1983).

This construction is completely consistent with §523(d)(8). This provision excepts debts from discharge (except for undue hardship) for three types of educational loans:

a) a loan for an educational debt (or educational benefit overpayment)

made, insured or guaranteed by a governmental or non profit entity;

b) an obligation to repay funds received as an educational benefit; or

c) a debt on a qualified loan under 26 U.S.C. §221(d)(1) incurred by an individual debtor.

The first type of loan, an educational loan guaranteed by governmental or nonprofit entities does not apply to the debtor's guarantee because the obligation was not for the debtor's education. He received no educational benefit from the loan.

The second type of loan does not apply to the debtor because he did not receive any funds any funds, whether as an educational benefit or for any other reason.

The third possibility could only apply to Mr. Solomon's case because the debt was not incurred by debtor solely for educational purposes and the debt was not incurred 'on behalf of" the debtor (or a spouse or dependent of the debtor).

The third possibility, a qualified educational loan described in 26 U.S.C. §221(d)(1) incurred by an individual debtor is the only type of loan likely to involve a co-signer under §523(a)(8). 26 U.S.C. §221(d)(1) describes this type of debtor:

"(d) Definitions
For purposes of this section—
(1) Qualified education loan
The term "qualified education loan" means any indebtedness incurred

> by the taxpayer solely to pay qualified higher education expenses—
> (A) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,
> (B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and
> (C) which are attributable to education furnished during a period during which the recipient was an eligible student.
> Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term "qualified education loan" shall not include any indebtedness owed to a person who is related (within the meaning of section 267 (b) or 707 (b)(1)) to the taxpayer or to any person by reason of a loan under any qualified employer plan (as defined in section 72 (p)(4)) or under any contract referred to in section 72 (p)(5)."

This definition would not apply to Mr. Solomon because the debt was not incurred solely to pay higher education expenses of the debtor, his spouse or a dependent. However, the language in this section could be used to prevent the discharge of a debt co-signed by a spouse of the debtor or if a dependent student's obligation was co-signed by a parent.

Notably, in adopting §221(d)(1) Congress found it necessary to add the additional language to cover such co-signers. It also illustrates the kind of language Congress would have used had it wished to except guarantees of educational loans from discharge.

The parties have two irreconcilable interpretations. Defendants argue a liability for a third party's default on an educational loan is a liability of the debtor for an educational loan. Plaintiff says the guarantee is a distinct obligation related to the loan and the rights and obligations under the single

note are different obligations for the primary and secondary obligors. Put another way, is the adjective "educational" meant to describe the nature or purpose of the debtor in taking on the "debt", to the purpose of the creditor or a primary obligor in making a loan.

Cases supporting both sides claim to base their rulings on the plain meaning of the statute, but nevertheless feel obliged to discuss legislative history. Eg. *Boylen*, id. at p. 926;

§528(d)(8) was enacted as part of the Bankruptcy Reform Act of 1978. Discussion of §523(d)(8) occupied a significant part of the legislative history connected to the 1978 Act.

During the 1978 debate, although co-signers of student loans were discussed, there was no suggestion that the obligation of a secondary co-signer could not be discharged because it was an educational loan. To be clear, several Representatives and House Report 95-595 stated that co-signers were simply not required for educational loans or were rarely required. Consequently, in discussing the educational loan discharge exception members of Congress generally did not refer to "debtors" with educational loans. Instead, in the context of the §528(d)(8) exception, the debtors were almost always referred to as "students" or "ex-students".

For example, in describing the exception to discharge Representative Ertel said,

> "this amendment is an amendment to the Bankruptcy Act which would prohibit discharge of ex-student loans for a period of 5 years after they became due, except when a severe hardship results to the student or his dependents." *Congressional Record - House*, February 1, 1978, p. 1791.

There appears to be no mention of any abusive co-signer in the legislative history and no discussion about whether co-signers were denied a discharge under §523(a)(8). At the time Congress enacted §523(a)(8), cosigners were unusual, although not unheard of. As House Report 95-595 explained,

> "GSL program regulations require lenders to use care in making loans, but do not require a credit check be performed. Because of the guarantee provisions, lenders make loans that they might not otherwise make. Cosigners are not normally required, nor is any security or collateral posted. The supposition is that the loans will be repaid out of the recipient's future earnings.
>
> "In contrast, other Federal and commercial loans are usually made based on financial analysis of the borrower. Cosigners are often required, or else there is some security involved. Because of these differences, which make the GSL program unique, we believe that a comparison of student loan bankruptcy will not provide meaningful information on which to assess the severity of the bankruptcy problem in student loan programs." *H.R. Report No. 95-595*, p. 136, U.S. Cong. & Admin. News 1978, p. 6038.

Representative Erlenborn explained that student loans were not like an ordinary business loan,

> "We hear the argument constantly that these students are being treated differently than the average person. The student is not like the average debtor. The average debtor has credit extended to him because he has assets. He pledges those assets plus his earning power to the payment of the debt.
>
> "The student does not have assets and would not, in the ordinary course of events be able to obtain credit. Because of this and because

> of our interest in seeing that young people have an opportunity to obtain an education, we have made loans available to them by extending the credit of the United States to guarantee that this loan will be repaid." _Congressional Record - House_, February 1, 1978, p. 1793.

In most cases governmental or nonprofit agencies acted as de-facto co-signers. The Guaranteed Student Loan program was explained by House Report 95-595,

> "Under the Guaranteed Student Loan program, loans are made to students by participating lenders such as commercial banks, savings and loan associations, credit unions and educational institutions. These loans are insured by the Office of Education or by State or private nonprofit guarantee agencies which have reinsurance agreements with the Office. In either case, if an individual fails to repay his loan because of default, bankruptcy, death, or disability, the lender may submit a claim to the Office of Education or the guarantee agency and receive payment of the unpaid balance. The Federal Government pays 100 percent of all lender loans on death and disability claims. On default and bankruptcy claims, the Federal Government pays 100 percent of lender losses on Office of Education insured loans and reimburses State or nonprofit agencies for 80 percent of their payments to lenders." _H.R. Report No. 95-595_, p. 140, U.S. Cong. & Admin. News 1978, p. 6101.

These statements of intent make it clear that Congress never meant to cover co-signers in the §523(a)(8) exception. There are many references to defaulting students and no references to co-signer defaults. In fact, the principal impetus for this exception was a collection of dozens of stories about students who were able to pay their educational loans but took the easier route of bankruptcy.

The record contains several references to the fact that student defaults occurred because loans were not made based on sound business principles.

In other words, the exception was designed to cover a different type of loan.

Representative Ertel commented that

> "Some people have said, 'Why should student loans be treated any differently than any other loans?'
>
> "Well, I would suggest that when one gets a business loan, one has collateral or something to justify that loan. But, on student loans the only thing one can put up for collateral is the ability he will have to make a better living after he has gotten that education. And so, what we have is an unsecured loan granted to students to get a better education.
>
> "...What it does prevent is when a student gets through school, having taken a student loan, comes out, and says, 'Well, it is nice to have a fresh start, I will not pay back my loan. I will declare bankruptcy and I will not have to worry about it.' And discharge the only loan that they have which is a student loan." *Congressional Record - House*, February 1, 1978, p. 1791.

House Report 95-595 pointed out that in 1978 the student loan program was not even designed to provide for co-signers,

> "The proponents of an exception to discharge have argued that educational loans are different from most loans. They are made without business considerations, without security, without cosigners, and relying for repayment solely on the debtor's future increased income resulting from the education. In this sense, the loan is viewed as a mortgage on the debtor's future. In addition, there have been abuses of the system by those seeking freedom from educational debts without ever attempting to repay." *H.R. Report No. 95-595*, p. 133, U.S. Cong. & Admin. News 1978, p. 6094.

It is true that Congress was concerned about the long term viability of the student loan program. However, the concern was less about the fiscal solvency of the program than its equitable and political foundation. The sentiment was captured in a letter from the Vermont Student Assistance Corp. placed in the record by Representative Ehrlenborn,

> "Administrators of student loan programs do not seek to prohibit students who are facing legitimate financial hardship from discharging their obligations in bankruptcy. ...We do however hope to maintain a means to prevent unscrupulous individuals from discharging loans which they are really in a position to pay or which are not even due for repayment at the time they are discharged." [— the letter then sets out stories of students who could have paid their loans but instead filed bankruptcy] *H.R. Report No. 95-595*, p. 158, U.S. Cong. & Admin. News 1978, p. 6119.

Of the members of the House who spoke about the §523(a)(8) exception, Representative Michel probably best expressed the prevailing sentiment,

> "We have a question of individual responsibility. Try to gauge the effect even a few declarations of bankruptcy must have an the vast majority of students who are trying their best to live up to high standards of responsibility. No wonder there is such cynicism about Government among the young.
>
> "Restrictions on student bankruptcies is logical. Section 316 is one of those pieces of legislation which on the surface, appears to be reasonable. After all, why not allow a student to declare bankruptcy? That makes it easier to everyone, does it not?
>
> "Well, in fact, it does not. It is time that the Congress spoke to the millions of students who have the decency to do what is right. Yes. I know that there are hardship cases. In which bankruptcy is unavoidable. But these are exceptions and as I understand it the amendment of Mr. Ertel allows these to occur. ...
>
> "I say it is time we do what is right for all students and that means, in this case, putting ourselves on the side of the majority of young men and women who want to do the right thing, even against great odds. The Ertel amendment does just that." *Congressional Record - House*, February 1, 1978, p. 1795.

Not only was a co-signed student loan not the sort of obligation addressed by the Congress, but in the 1978 Reform Act Congress acted to reign in the sometimes oppressive overreach of creditors against co-signers.

In the discussion of a different part of the Bankruptcy Code, House Report 95-595 discussed a new provision protecting co-signers in Chapter 13 cases,

> "Finally, the existing chapter 13 statute is basically and seriously defective at this time in five respects. ...Fourth, accommodation codebtors in consumer finance are usually inexperienced relatives or coworkers, and present law does not provide a reasonable restraint on collection from the[m] while the debtor's case is pending." _H.R. Report No. 95-595_, p. 13, U.S. Cong. & Admin. News 1978, p. 5799.

Legislative history also suggests this exception was designed to have limited applicability. Representative Dodd explained that the fresh start in bankruptcy and equal treatment for creditors were important pillars of bankruptcy law:

> "We are not here today to deal with horror stories. We are here to deal with a very sensitive area of bankruptcy law, because it will have the potential of affecting the lives of 10 million people in this country who happen to be students and who happen to need assistance when they are going to college.
>
> The right to go to bankruptcy court is something that is extended to every single citizen of this country, and there are two fundamental principles that apply when we go about bankruptcy. One is to provide people with a fresh start, and the other is to treat debtors and creditors equally. _Congressional Record - House_, February 1, 1978, pp. 1792-1793.

Representative Edwards echoed this sentiment and suggested a strong argument would have to support any expansion of exceptions to discharge,

> "As a starting point, two of the fundamental policies behind the bankruptcy laws are equality of treatment of all creditors and a fresh start for the debtor. The first policy dictates that certain creditors not be given an advantage over other creditors. The second dictates that the discharge in bankruptcy be complete and effective. Of course, these policies are not absolute, but they are very strong. Any exception must be justified by the strongest showing of need and of sound policy.

> The need does not appear to be present here, nor does policy suggest that an exception is appropriate." _H.R. Report No. 95-595_, p. 152, U.S. Cong. & Admin. News 1978, p. 6113.

The record also suggests the exception was specifically aimed at students. Remarks in the legislative debates on the exception refer to students or ex-students. There appears to be no reference of any kind to liability of co-signers other than a couple of references to the fact that co-signers were not required for educational loans. Moreover, the remarks are often very specifically directed at students. For instance, Representative Erlenborn said, as quoted earlier,

> "We hear the argument constantly that these students are being treated differently than the average person. The student is not like the average debtor. The average debtor has credit extended to him because he has assets. He pledges those assets plus his earning power to the payment of the debt.
>
> "The student does not have assets and would not, in the ordinary course of events be able to obtain credit. Because of this and because of our interest in seeing that young people have an opportunity to obtain an education, we have made loans available to them by extending the credit of the United States to guarantee that this loan will be repaid." _Congressional Record - House_, February 1, 1978, p. 1793.

In opposing the exception to discharge Representative Butler complained that students were being singled out,

> "But keep in mind that if this amendment passes, if the Ertel amendment passes, this will be the only provision in the bankruptcy law excepting from the bankruptcy act a particular kind of voluntarily incurred debt for discharge. It is a bad policy to single out the student borrower for this sort of treatment. ...It is just wrong to single out the student for this kind of treatment." _Congressional Record - House_, February 1, 1978, p. 1797.

The dozens of specific cases cited during the discussion of §523(a)(8) related each followed the same pattern and this template was very specific to the student borrower. A student benefits from an education paid for with the proceeds from an educational loan and then defaults even though objective circumstances suggest an unwillingness rather than inability to make the required loan payments. As Representative Ehrlenborn described the problem,

> "where former students have filed for bankruptcy on rather spurious grounds. The New York Times, for example, reported last November 21 the case of a man who discharged his $12,000 debt through bankruptcy. In that case, the bankruptcy referee, Judge William Rudin, was quoted as saying 'Sometimes you know they are here to get out of paying back a loan because they don't feel like having it anymore.' Other reports cite instances where students just out of law school hove filed bankruptcy, and there are more than a few instances where colleges and school officials have declared bankruptcy even though holding a responsible, well paying job and where the student loan involved the majority of the obligations in bankruptcy.
> ...The Illinois Guaranteed Loan Program Director stated 'We seek only a means to prevent the dishonorable borrower with good income expectation from taking advantage of his temporary state of unemployment and lack of assets immediately after graduation.' The Director of the Virginia State Education Assistance Authority said in part: 'Our finding is that bankruptcies are increasing rapidly in our program ... In practically all cases student loan borrowers are young, healthy, have very few obligations beyond the student loan, and have a long time of learning ability ahead of them.' The Wisconsin Higher Education Aid Board wrote 'In Wisconsin there has been a tremendous increase in student loan bankruptcy claims...It is true that the percentage of student loan bankruptcies to total loans or total defaults is not that large. But given all recent indications, a large increase in the number and amount of student loan bankruptcies will occur." *H.R. Report No. 95-595*, p. 158, U.S. Cong. & Admin. News 1978, pp. 6117-6118.

Since the justification for the exception related to circumstances specific to students and because the legislative record deals exclusively with student abuses and the effect of such abuses on the student loan program, Congress had no reason to apply the exception to non-student co-signers of educational loans.

Dated: September 26, 2013.

TWIN CITY ATTORNEYS, P.A.

/e/ James C. Whelpley

Attorneys for Plaintiff
By James C. Whelpley
Attorney I.D. 11649X
2151 North Hamline Avenue
Suite 202
Roseville, MN 55113
Telephone: (651) 639-0313